

TESTIMONY OF
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U.S. DEPARTMENT OF COMMERCE
BEFORE THE
COMMITTEE ON GOVERNMENT REFORM

Mr. Chairman and members of the Committee, thank you for the opportunity to address your concerns on the use of domestic source restrictions by foreign governments. Since standards and technical regulations affect over 80 percent of global commodity trade, domestic source restrictions by foreign governments, in the form of standards as trade barriers, are a concern and have prompted the Department of Commerce to take recent action.

The Department of Commerce is committed to ensuring that standards are fair and responsive to market and technology needs, and that we partner with industry to combat standards as trade barriers to American goods and services. In March 2003, the Department launched a Standards Initiative, under former Secretary Donald L. Evans, to meet this commitment. Current Commerce Secretary Carlos Gutierrez has reinforced this focus as he begins his tenure in the President's Cabinet.

The Department of Commerce Standards Initiative specifically addressed U.S. industry concerns that issues relating to standards and conformity assessment in foreign markets were among the greatest barriers to expanding exports. U.S. businesses were pushing for a fair and equitable standards playing field, where standards would be judged not only on their technical merits but also on their developers' adherence to the principles of transparency, openness, impartiality and consensus, effectiveness and relevance, and coherence.

In May 2004, as a follow-on to the Standards Initiative, the Department released, *Standards and Competitiveness: Coordinating for Results*, a report to reduce standards-related trade barriers that called for broader collaboration across government and with U.S. industry to prevent technical obstacles that impede U.S. exports. The Department of Commerce report can be accessed at <http://www.technology.gov/Reports.htm>.

The report focused on improving the efficiency and effectiveness of the Department's standards-related programs and policies. It emphasized best practices, provided critical education and training, expanded our early warning tools, and created greater collaboration with industry and government. Collectively, these actions will go a long way towards an effective rapid response system when standards become trade barriers.

The report's recommendations have also helped the Department identify new opportunities and better ways to work with the private sector and other U.S. government agencies on standards-related concerns. The recommendations outlined how we can improve on tackling standards issues that distort trade and undermine our competitiveness. Information for the report was gathered from more than 200 industry associations and standards organizations in 13 industry roundtables convened over a year.

In the face of intensifying global competition, neither industry nor government can be complacent about standards-related issues. In close collaboration with industry, the Department is pursuing an active multi-pronged strategy with respect to standards-related issues around the globe, with particular attention on China. This strategy includes continued engagement at the policy and technical levels to deal with specific issues as they arise, providing grant support where appropriate to U.S. standards developing organizations to open offices in China, posting a standards attaché to the U.S. Embassy in Beijing this summer, and sponsoring an ongoing series of both general and sector-specific workshops involving Chinese officials and relevant U.S. private and public sector interests.

While U.S. standards concerns are not specific to just China, because American industry has demonstrated a clear interest to compete and participate in the Chinese marketplace, it is important that there is a standards development process that is open, transparent, participatory, and fair in China. In 2004, China was the United States' third largest trading partner, with total merchandise trade between the two nations reaching \$231 billion. The United States exported over \$35 billion of merchandise to China, an increase of over 25 percent over the previous year.

To further the dialogue between the U.S. and China, last August, I led a 70-member U.S. industry-government delegation that completed a two-day workshop in Beijing in order to address some of the most challenging issues facing the U.S.-China trade relationship. The U.S.-China Standards and Conformity Assessment Workshop, was hosted by the U.S. Department of Commerce and China's General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) to seek greater cooperation in standards development and conformity assessment issues.

The U.S. delegation represented major industrial sectors, leading corporations, and top standards organizations. The workshop addressed industry concerns that standards can be used as technical barriers to trade. This event was organized at the behest of the U.S. private sector and resulted from agreements reached at the 15th Session of the U.S.-China Joint Commission on Commerce and Trade meeting held in April 2004 between Commerce Secretary Donald Evans, U.S. Trade Representative Robert Zoellick, and Vice Premier Wu Yi.

The workshop responded to industry needs and furthered the ongoing cooperation between the United States and China on standards and testing issues. A strong partnership between the public and private sectors in both countries can ensure that standards

development processes are responsive to market and technology needs, while promoting and not hindering trade.

Collaboration and continued dialogue on critical standards-related issues are important to strengthening good relations between all of our nation's trading partners. Tensions have arisen, however, when certain countries take restrictive action that could potentially exclude market access to U.S. businesses. In this regard, I have been asked by the Committee to address a specific example where China has caused great concern with U.S. industry in its application of domestic source requirement standards – China's pending software procurement regulation which could limit the ability of U.S. industry to sell software products and services to the Chinese government.

U.S. software companies, which are widely recognized as industry leaders for their leading-edge innovation, have invested billions of dollars in China to participate directly in China's growing information technology market. This is especially necessary to combat and offset the perceived high rate of software piracy in China. Accordingly, the Chinese government, as a major source of legal software purchases, represents an important market for the U.S. software industry. China's proposed procurement rules undermine its stated goal of developing a domestic software industry, which requires close collaboration with foreign software producers and foreign investment in the sector. On a political level, the proposed domestic preference set forth in China's procurement policy also runs counter to the spirit of Premier Wen Jiabao's commitment to reducing our trade deficit with China by increasing U.S. exports.

The Department of Commerce, working closely with other U.S. Government agencies, has been actively engaging the Chinese government to ensure that U.S. companies are not excluded from the government procurement market.

CHINA'S GOVERNMENT PROCUREMENT SYSTEM

China published its Government Procurement (GP) Law during the summer of 2002. The GP Law went into effect on January 1, 2003, and was the first step in China's effort to create a modern and comprehensive procurement system for the Chinese government at all levels. The Law was modeled after the United Nations Model Law on Government Procurement and attempts to follow international procurement principles. It includes a preference for the Chinese government to procure domestic products and services, with limited exceptions, and software is the first category of procurements for which the Chinese government has begun drafting regulations to implement this domestic preference policy.

Although China acceded to the World Trade Organization (WTO) on December 11, 2001, China is not yet a member of the WTO Agreement on Government Procurement (GPA) and, consequently, does not have any WTO market access obligations in the area of government procurement. When China joined the WTO, it did, however, commit to conduct its government procurement in a transparent manner and to provide all foreign

suppliers with equal opportunity to participate in procurements opened to foreign suppliers (Most Favored Nation principle). It also committed to become an observer to the GPA and to table an offer and initiate negotiations for membership to the GPA “as soon as possible.”

In February 2002, China became an observer to the WTO Committee on Government Procurement but, to date, it has not tabled an offer to begin negotiations on GPA accession.

CHINA’S PROPOSED SOFTWARE PROCUREMENT POLICY

China’s Ministries of Finance (MOF) and Information Industry (MII) held a joint forum to present the basic framework and key aspects of its draft software government procurement implementing measures in November 2004 and released a partial copy of the regulations for public comment. In the works since early 2003, the published draft, though only a summary, identified for the first time the methodology China was considering to determine whether a given software product or service qualifies as being “domestic”. This methodology consisted of a three-part requirement: software products would need to be made within China, its copyright belong to an entity registered in China, and its China-based development costs exceed fifty percent of its total development cost in order to be classified as being “domestic”. The summary of the draft regulations also proposed that a software service would similarly qualify if the cost of services provided by a company registered outside of China does not exceed thirty percent of the total cost of the services to be provided.

The summary also highlighted China’s intent to implement a three-tier preference for government procurements. For those products that would not qualify as “domestic”, the Chinese government would establish a catalogue of foreign software for preferential procurement to differentiate products from foreign suppliers whose domestic investment, domestic research and development, subcontracting to Chinese enterprises or taxes paid in China exceed certain yet-to-be-determined thresholds from the products of all other potential foreign suppliers.

In April 2005, after repeated requests from the U.S. Government and industry, China released for public comment a complete draft of the software procurement implementing measures. Although the revised draft appeared to incorporate some U.S. Government comments, it retained the same definition of “domestic” and three-tier preference structure, including the catalogue of foreign software for preferential procurement, as the previous draft.

U.S. GOVERNMENT ACTIONS

The Department of Commerce, in close coordination with the Department of State and Office of the U.S. Trade Representative, has been actively engaging the Chinese government on this issue since Summer 2003. Our strategy has been a combination of bilateral dialogue, industry-to-government exchanges and multilateral coordination.

These have included the provision of technical assistance on government procurement-related topics to relevant Chinese policymakers; facilitation of industry exchanges with key officials at the MOF, MII, and the State Council Informatization Office (SCITO); communication of our concerns directly through bilateral exchanges between U.S. and Chinese senior leadership; and solicitation of our key trading partners such as the European Union and Japan to engage China directly on this issue. We continue our strong efforts on this issue.

In particular, I would emphasize that we have taken every opportunity to raise this issue with our Chinese counterparts, at levels ranging from Deputy Division Director to Vice Premier. Under Secretary for Technology Phil Bond raised the issue with SCITO Vice Minister Yang Xueshan and I also raised the issue with the Vice Minister, as well as with MII Vice Minister Xi Guohua, during my August 2004 trip to Beijing. In addition, former Commerce Secretary Evans raised the issue on several occasions since October 2003 with Vice Premier Wu Yi, Vice Premier Zeng Peiyan and MII Minister Wang, the most recent of which occurred during his final trip to China in January 2005.

We have also approached the European Union and Japan repeatedly to enlist their support in this effort. The European Union in particular is lobbying aggressively for China to begin negotiations on GPA accession, while Japan's Ministry of Economy, Trade and Industry has raised the issue with China's Ministry of Commerce.

IMPACT OF CHINA'S SOFTWARE PROCUREMENT POLICY

In our exchanges with the Chinese government, our message is clear and consistent. By moving to implement this policy, China would be undermining its explicitly stated objective of encouraging the development of a domestic software industry.

Developing global software requires the formation of partnerships between foreign and domestic companies to provide users the best products at the lowest total costs of ownership. Restricting the purchase of foreign software discourages foreign software vendors from seeking cooperative associations with local companies, which can isolate Chinese domestic companies from the international software community. Furthermore, firms generally invest in research facilities where there is an active market for the results of their research and a strong likelihood of recouping their investment costs. In the face of limited market potential, many foreign firms are likely to reduce their research and development investment in China either to the barest minimum that will be required under the implementing measures or to eliminate it completely. China's best hope for software development lies in the creation and enforcement of intellectual property rights, not in the implementation of these restrictive measures.

The potential impact of China's proposed software procurement measures on the U.S. software industry is less certain but certainly would not be positive. We are concerned that the overly restrictive definition of domestic software contained in the draft regulations has the potential to sharply restrict the sales of U.S. software to the Chinese government.

CONCLUSION

The U.S. Department of Commerce, along with the Department of State and Office of the U.S. Trade Representative, have been working hard to ensure that U.S. software companies continue to have access to Chinese government customers. We will continue to work vigorously to achieve this goal.

Thank you Mr. Chairman. I would be happy to address any questions you or the members of the committee may have.